Warning Signs are There for Another Economic Catastrophe

WASHINGTON. D.C. – House Committee on Oversight and Government Reform Ranking Member Darrell Issa (R-CA) today called on EVERY member of Congress to review the quarterly report released by SIGTARP Neil Barofsky and to take to heart what Barofsky warns will happen if policymakers continue to ignore the role that government intervention has played in contributing to and prolonging the economic crisis.

“While members of Congress pontificating on Sunday Shows like to say that tax cuts and Wall Street led to our financial meltdown, they continue to ignore the role that politics and government played in creating the housing bubble that paved the way for our economic collapse,” Issa said. “The SIGTARP report is very clear, unless the Congress takes a detour from their current path – another and much deeper financial meltdown is inevitable.”

In July of last year, Ranking Member Issa released a report detailing the role that the government’s ‘affordable housing policies’ played in creating the global financial crisis. According to the report, government intervention “created ‘affordable’ but dangerous lending policies which encouraged lower down payments, looser underwriting standards and higher leverage. Finally, government intervention created a nexus of vested interests – politicians, lenders and lobbyists – that profited from the ‘affordable’ housing market and acted to kill reforms. In the short run, this government intervention was successful in its stated goal – raising the national homeownership rate.”

Issa added, “These are smoking gun reports that highlight the perils in continuing the bailout first mentality that has continued to leave us vulnerable to repeat the cycle that led to the financial meltdown. Congress and the Administration need to act thoughtfully, deliberately and honestly to stave off another collapse.”

Key Facts and Conclusions from the Issa’s report included:Key Facts and Conclusions from the Issa’s report included:

• Political pressure led to the erosion of responsible lending practices: In the early 1990s, Fannie and Freddie began to come under considerable political pressure to lower their underwriting standards, particularly on the size of down payments and the credit quality of borrowers. (p.6)

• Lower down payments led to housing prices that outpaced income growth: Once government-sponsored efforts to decrease down payments spread to the wider market, home prices became increasingly untethered from any kind of demand limited by borrowers’ ability to pay. Instead, borrowers could just make smaller down payments and take on higher debt, allowing home prices to continue their unrestrained rise. Some statistics help illustrate how this occurred. Between 2001 and 2006, median home prices increased by an inflation-adjusted 50 percent, yet at the same time Americans’ income failed to keep up. (p. 11)

• Members of an “affordable housing” coalition shared profits with political allies to help legitimize their business practices: Fannie Mae created and used The Fannie Mae Foundation to spread millions of dollars around to politically-connected organizations like the

Congressional Hispanic Caucus Institute. It also hired well-known academics to give an aura of academic rigor to policy positions favorable to Fannie Mae. One paper coauthored by now-Director of the Office of Management and Budget Peter Orszag, concluded that the chance was minimal that the GSEs were not holding sufficient capital to cover their losses in the event of a severe economic shock. The authors suggested that “the risk to the government from a potential default on GSE debt is effectively zero,” and that “the expected cost to the government of providing an explicit government guarantee on $1 trillion in GSE debt is just $2 million.” (p.7)

• The Government Sponsored Enterprises led the way into the housing crisis: Fannie Mae and Freddie Mac were leaders in risky mortgage lending. According to an analysis presented to the Committee, between 2002 and 2007, Fannie and Freddie purchased $1.9 trillion of mortgages made to borrowers with credit scores below 660, one of the definitions of “subprime” used by federal banking regulators. This represents over 54% of all such mortgages purchased during those years. (p.24)

The SIGTARP report also detailed how the Treasury Department continues to stonewall “one of SIGTARP’s most important recommendations” – the implementation of “strict information barriers or ‘walls’ between the PPIF managers making investment decisions on behalf of the PPIF and those employees of the fund management company who manage non-PPIF funds trading in the same kinds of securities.” As the report says, “for various reasons, Treasury has decided that requiring such walls ‘is simply not practical in the context of PPIP,’ and has refused to adopt this recommendation.

“It is disappointing but not unsurprising that the Treasury Department under the leadership of Secretary Geithner is once again stonewalling transparency,” Issa said. “Frankly, just because it may be inconvenient is not a good enough excuse to justify leaving taxpayer dollars vulnerable to manipulation and fraud. It’s downright deceptive for this Administration to talk about accountability and transparency while refusing to impose conflict-of-interest barriers recommended by the SIGTARP.”